

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B04

PLR-121067-08

Date: OCTOBER 20, 2008

Date of Death:

Date 1 =
Decedent =
Trust =
Date 2 =
Spouse =
Daughter =
Law Firm =
Date 3 =
Date 4 =
a =
b =
c =
Company =

Dear :

This responds to your representative's letter dated April 30, 2008, requesting an extension of time under § 301.9100-3 of the Procedure and Administration Regulations to sever a trust into an exempt and nonexempt trust for purposes of generation-skipping transfer (GST) tax and to make a "reverse" qualified terminable interest property (QTIP) election under § 2652(a)(3) of the Internal Revenue Code with respect to the exempt trust.

The facts submitted and representations made are as follows.

On Date 1, Decedent created Trust, a revocable trust. On Date 2, Decedent died, whereupon Trust became irrevocable. Decedent was survived by Spouse and Daughter.

Article 3 of Trust provides that if Decedent predeceases Spouse, then upon Decedent's death, the trustee shall divide the trust estate into two trusts. The Marital Trust is to consist of the minimum amount necessary to reduce the federal estate tax to zero. The Family Trust is to consist of the balance of the trust estate.

Article 3.2 of Trust contains the provisions of the Marital Trust. Subsection (a) of Article 3.2 provides for distributions of income and principal to Spouse during her lifetime. Subsection (b) provides that if the executor of Decedent's estate makes an election under § 2652(a)(3), the trustee may divide the corpus of the Marital Trust into two fractional share trusts. The share for which the election is made is to consist of the amount of GST exemption allocated to the Marital Trust, and the other share is to consist of the remaining portion of the trust. Subsection (d) provides Spouse with a testamentary special power of appointment to appoint the remaining balance of the Marital Trust to or for the benefit of one or more of Decedent's issue. Upon the death of Spouse, the Marital Trust shall terminate and its remaining balance (after the exercise by Spouse of Spouse's special power of appointment) shall be distributed as provided in Article 3.3 of Trust.

Article 3.3 of Trust provides that upon the death of Spouse, the unappointed balance of the Marital Trust and Family Trust shall be divided into as many equal shares as there are children of Decedent then living and children of Decedent then deceased, but leaving issue then living. Shares for each child then living shall be held in further trust pursuant to Article 3.4 of Trust and shares for the then living issue of each of those children then deceased shall be distributed in fee simple, per stirpes, and free of trust.

Article 3.4 of Trust provides that for each separate share created pursuant to Article 3.3, the trustee may distribute income and principal as the trustee deems advisable to provide for the support, maintenance, health, and education of the child of Decedent for whom the share was created and the issue of that child. The child of Decedent for whom the share was created has a testamentary special power of appointment to appoint the remaining balance of the separate trust to or for the benefit of any one or more persons, corporations, or other entities other than to the child, the child's estate, the child's creditors, or the creditors of the child's estate. Upon the death of the child, the separate trust shall terminate and its remaining balance (after the exercise by the child of the child's special power of appointment) shall be distributed in fee simple, per stirpes, and free of trust, to the child's then living issue.

Article 4.1 of Trust provides that before any trust with an inclusion ratio between one and zero, as defined in § 2642(a)(1), is funded, the trustee may divide the trust into two

separate trusts. One trust shall have an inclusion ratio of zero, and one trust shall have an inclusion ratio of one.

Spouse, as co-executor of the estate, engaged Law Firm to prepare and assist her in the timely filing of Decedent's United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706). The Form 706 was timely filed on Date 3. On Schedule M, Bequests, etc., to Surviving Spouse, the estate made the election under § 2056(b)(7) to treat the property of the Marital Trust as qualified terminal interest property (QTIP). The Form 706 reflects that the Marital Trust was funded with a total of \$a in assets.

On Schedule R, Generation-Skipping Transfer Tax, \$b of Decedent's GST tax exemption was allocated to the Family Trust. The Form 706 reflects that the Family Trust was funded with a total of \$c in assets, an amount less than \$b. Accordingly, to the extent the amount allocated exceeded the amount necessary to obtain an inclusion ratio of zero with respect to Family Trust, the allocation was void. See § 26.2632-1(b)(4)(i) of the Generation-Skipping Transfer Tax Regulations.

Law Firm failed to advise Spouse how to fully utilize Decedent's GST tax exemption by severing the Marital Trust into a GST exempt marital trust and a GST nonexempt marital trust and by making an election under § 2652(a)(3) (a "reverse" QTIP election) to treat all of the property in the GST exempt marital trust as if the election to be treated as QTIP had not been made for purposes of Chapter 13.

On Date 4, Company was appointed as the successor trustee of the Family Trust and the Marital Trust. Company reviewed the trust instrument and Decedent's Form 706 and discovered the incorrect allocation of Decedent's GST exemption. Company also realized that the Marital Trust should have been severed into a GST exempt marital trust and a GST nonexempt marital trust and that the remaining balance of Decedent's GST exemption should have been allocated to the exempt trust, in accordance with the relevant provisions of Trust.

Company, in its capacity as trustee of the Marital Trust, has requested the following rulings:

1. The successor trustee is granted an extension of time under § 301.9100-3 to sever the Marital Trust under § 26.2654-1(b)(1) of the Generation-Skipping Transfer Tax Regulations into a GST exempt marital trust and a GST nonexempt marital trust.
2. The decedent's estate is granted an extension of time under § 301.9100-3 to file a supplemental Form 706 making a reverse QTIP election under § 2652(a)(3) with respect to the GST exempt marital trust.

3. The automatic allocation rules of § 2632(e) will operate to cause the unused portion of Decedent's GST exemption to be allocated to the GST exempt marital trust.

Section 2001(a) of the Internal Revenue Code imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2056(a) provides that, for purposes of the tax imposed by § 2001, the value of the taxable estate is to be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property that passes or has passed from the decedent to the surviving spouse.

Section 2056(b)(1) provides, in pertinent part, that no deduction shall be allowed under § 2056(a) where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail.

Section 2056(b)(7)(A) provides that, in the case of qualified terminable interest property, the entire property shall be treated as passing to the surviving spouse for purposes of § 2056(a), and no part of such property shall be treated as passing to any person other than the surviving spouse for purposes of § 2056(b)(1)(A).

Section 2056(b)(7)(B)(i) defines the term "qualified terminable interest property" as property: (I) which passes from the decedent; (II) in which the surviving spouse has a qualifying income interest for life; and (III) to which an election under § 2056(b)(7) applies.

Section 2056(b)(7)(B)(v) provides that an election under § 2056(b)(7) with respect to any property shall be made by the executor on the return of tax imposed by § 2001, and that such an election, once made, shall be irrevocable.

Section 2601 imposes a tax on every GST. A "generation-skipping transfer" is defined under § 2611(a) as: (1) a taxable distribution; (2) a taxable termination; and (3) a direct skip.

Section 2602 provides that the amount of the GST tax is determined by multiplying the taxable amount by the applicable rate.

Section 2641(a) defines the term "applicable rate" with respect to any GST as the product of the maximum federal estate tax rate and the inclusion ratio with respect to the transfer. Under § 2642(a)(1), the inclusion ratio with respect to any property transferred in a GST is generally defined as the excess of 1 over the "applicable fraction." With respect to a GST that is not a direct skip, the applicable fraction is generally defined under § 2642(a)(2) as a fraction the numerator of which is the amount

of the GST exemption under § 2631 allocated to the trust and the denominator of which is the value of the property transferred to the trust.

Under § 2631(a), as in effect on Date 2, for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of \$1,000,000 (adjusted for inflation under § 2631(c)) that may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor. Section 2631(b) provides that any allocation under § 2631(a), once made, shall be irrevocable.

Section 2632(a)(1) provides that any allocation by an individual of his or her GST exemption under § 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for such individual's estate (determined with regard to extensions), regardless of whether such a return is required to be filed.

Under § 26.2632-1(d)(1) of the Generation-Skipping Transfer Tax Regulations, an allocation of a decedent's available GST exemption by the executor of the decedent's estate is made on the estate tax return filed on or before the date prescribed for filing the return by § 6075(a) (including any extensions granted). An allocation of GST exemption with respect to property included in the gross estate of a decedent is effective as of the date of death.

Under § 2632(e)(1) and § 26.2632-1(d)(2), a decedent's unused GST exemption is automatically allocated on the due date for filing the Form 706 to the extent not otherwise allocated by the decedent's executor on or before that date. The unused exemption is allocated: (A) first, to property which is the subject of a direct skip occurring at such individual's death, and (B) second, to trusts, with respect to which such individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after such individual's death. However, no automatic allocation of GST exemption is made to a trust that will have a new transferor with respect to the entire trust prior to the occurrence of any GST with respect to the new trust.

Under § 2652(a)(1) and § 26.2652-1(a)(1), the "transferor" of the property for GST tax purposes is the individual with respect to whom the property was last subject to federal estate or gift tax. However, under § 2652(a)(3), in the case of a trust for which a deduction was allowed under § 2056(b)(7), the decedent's estate may elect to treat all of the property in the trust as if the § 2056(b)(7) election had not been made for purposes of the GST tax. This election is referred to as a "reverse QTIP election." Accordingly, the decedent, and not the surviving spouse, is treated as the transferor of the property for GST tax purposes. The reverse QTIP election is irrevocable and is not effective unless it is made with respect to all of the property in the trust to which the QTIP election applies. Under § 26.2652-2(b), the reverse QTIP election is made on the return of tax on which the QTIP election is made.

Under § 26.2654-1(b)(1)(ii), the severance of a trust that is included in the transferor's gross estate into two or more trusts is recognized for purposes of chapter 13 if the governing instrument does not require or otherwise direct severance but the trust is severed pursuant to discretionary authority granted either under the governing instrument or under local law; and

- (A) The terms of the new trusts provide in the aggregate for the same succession of interests and beneficiaries as are provided in the original trust; and
- (B) The severance occurs prior to the date prescribed for filing the federal estate tax return (including extensions actually granted) for the estate of the transferor; and
- (C) Either (1) the new trusts are severed on a fractional basis or (2) if the severance is required (by the terms of the governing instrument) to be made on the basis of a pecuniary amount, the pecuniary payment is satisfied in a manner that would meet the requirements of § 26.2654-1(a)(1)(ii) if it were paid to an individual. If severed on a fractional basis, the separate trusts need not be funded with a pro rata portion of each asset held by the undivided trust. The trusts may be funded on a non pro rata basis provided funding is based on either the fair market value of the assets on the date of funding or in a manner that fairly reflects the net appreciation or depreciation in the value of the assets measured from the valuation date to the date of funding.

Under § 301.9100-1(c), the Commissioner has discretion to grant a reasonable extension of time under the rules set forth in §§ 301.9100-2 and 301.9100-3 to make a regulatory election, or a statutory election (but no more than 6 months except in the case of a taxpayer who is abroad), under all subtitles of the Internal Revenue Code except subtitles E, G, H, and I.

Section 301.9100-3 provides the standards used to determine whether to grant an extension of time to make an election whose due date is prescribed by a regulation (and not expressly provided by statute).

Requests for relief under § 301.9100-3 will be granted when the taxpayer provides the evidence to establish to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and the grant of relief will not prejudice the interests of the Government.

Section 301.9100-3(b)(1)(v) provides that a taxpayer is deemed to have acted reasonably and in good faith if the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election.

In this case, because a QTIP election was made on Decedent's Form 706, the assets of Marital Trust will be included in Spouse's gross estate pursuant to § 2044. Spouse will become the transferor of such property for GST tax purposes, thereby precluding the allocation of any of Decedent's GST exemption to Marital Trust. However, if Decedent's estate is granted an extension of time to sever Marital Trust into a GST exempt Marital Trust and a GST nonexempt Marital Trust and to make a reverse QTIP election with respect to the GST exempt Marital Trust, Decedent will be treated as the transferor of the GST exempt Marital Trust for GST tax purposes.

Based on the facts and representations made, we have determined that the standards of §§ 301.9100-1 and 301.9100-3 have been met. Therefore, an extension of time is granted until 60 days from the date of this letter: (1) to sever Marital Trust into a GST exempt marital trust and a GST nonexempt marital trust, effective retroactively to Decedent's date of death; and (2) to make a "reverse" QTIP election with respect to the assets of the GST exempt marital trust. As a result of the severance and the "reverse" QTIP election with respect to the GST exempt marital trust, Decedent's remaining GST exemption (after the previous allocation to the Family Trust) will be allocated to the GST exempt marital trust under § 2632(e)(1). Therefore, provided that the trusts are funded as described in § 26.2654-1(b)(1)(C), the Family Trust and the GST exempt marital trust will have an inclusion ratio of zero, and the GST nonexempt marital trust will have an inclusion ratio of 1.

The reverse QTIP election should be made on a supplemental Form 706. The supplemental Form 706 should be filed on behalf of Decedent's estate with the Internal Revenue Service Center, Cincinnati, OH 45999. A copy of this letter should be attached.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Curt G. Wilson
Deputy Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosure: Copy for § 6110 purposes